

OFT the beaten track?

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In this article, the authors suggest that if need, consumer protection, access and social justice come before competition, then the Office of Fair Trading may have over-stepped the mark.

The Office of Fair Trading (OFT) recommendation that control of entry regulations should cease is causing considerable concern among pharmacists. After approximately 14 months of formal inquiry, the OFT has concluded that the existing rules:

- * Restrict consumer choice and convenience**
- * Restrict access to lower priced over-the-counter (OTC) medicines**
- * Reduce incentives for pharmacies to compete**
- * Cost businesses an estimated £16m in compliance costs every year**
- * Cost the National Health Service approximately £10m a year in administration costs**
- * Hold back innovation and responsiveness to changing consumer needs**

For those in the profession keen to sustain the existing system for locating community outlets, these findings are damning. In effect, the OFT has found that liberalisation will benefit consumers while reducing administration costs to the Government and (existing and potential) pharmacies.

Given that the pharmacy profession has missed its opportunity to demonstrate to the OFT that control of entry should be sustained, those wishing to protect the prevailing arrangements must now convince the Government of their benefit. To be successful, opponents must persuade Ministers to ignore the OFT's findings, probably without providing more evidence of the type already reviewed.

In response to the need for a different approach, we attempt to re-evaluate the OFT's role in investigating pharmacy locations. Following an analysis of these issues, we conclude that competition may only be a minor issue for the Government in determining overall NHS and pharmacy policy. Therefore, the pharmacy profession should defend itself by stressing the conflicting policy objectives surrounding control of entry, rather than trying to disprove that the current system leads to higher prices for OTC drugs.

New approach

As an independent professional organisation, the OFT plays a leading role in promoting and protecting consumer interests throughout the United Kingdom while ensuring that business practices are fair and competitive. Following the publication of the White Paper "Productivity and enterprise: a world class competition regime", the Enterprise Act 2002 established the OFT as a Crown body, with no statutory powers. With its new structure came significant new resources to help the OFT pro-actively examine specific markets in order to suggest how they could be made to work better for consumers. To help deliver its new agenda, the OFT established its markets and policy initiatives (MPI) division in 2001 to examine regulatory and other legal restrictions on UK markets.

Pharmacy locations, consumer IT services and extended warranties for electrical goods were the first areas of investigation for the MPI. Since these were the new division's first inquiries, pharmacy locations, IT services and extended warranties were chosen before the OFT had published formal guidelines on how markets should be selected for MPI investigation.

Legal power

The pharmacy investigation was launched by the OFT in October 2001 and was carried out under Section 2 of the Fair Trading Act 1973. Section 2 requires the Director General of Fair Trading to keep commercial activities in the UK under review in order to detect monopoly situations and investigate areas of concern.

Although the body had the legal powers required to investigate pharmacy, IT and warranties, that did not imply that these studies would eventually result in legal proceedings. At their launch, the director general said they will be "exploratory studies, not inquisitions", adding, "no one is in the dock — though if a study reveals the need for further investigation or action under any of our enforcement powers, we will act accordingly".

The OFT traditionally operates in a quasijudicial manner reporting particular breaches of competition rules to various courts. For instance, the earlier resale price maintenance case was referred to the Restrictive Practices Court on grounds on consumer interest. Similarly, the study by the OFT investigation into prescription-only veterinary medicines was referred to the Competition Commission after UK prices were found to be higher than those in other European countries. However, in this particular case, the OFT is acting as "law-maker" rather than "law-enforcer", which has important implications for the way in which the pharmacy case was handled.

For instance, pharmacists should not believe that they are trying to produce sufficient evidence to win their side on legal grounds. Instead, the OFT's emphasis on competition should be challenged, and the ways in which control of entry promotes better access and market stability should be stressed.

Pharmacy investigation

When first launched, the pharmacy study was designed to examine the market for retail pharmacy services and, in particular, whether consumers are best served by the system that regulates where pharmacies can open. As an underlying philosophy to all its investigations, the OFT is guided by the principle that competitive markets with no barriers to entry generally serve best the interests of consumers. In general usage, competition implies that consumers receive either a better service at the same costs, the same service at lower costs or more benefits and lower prices simultaneously. In the case of pharmacy locations, the MPI would have to find that liberalisation could improve the quality of service patients receive, lower OTC prices, or a mixture of both.

Unlike most OFT investigations, the pharmacy case was complicated by the fact that two goods were being considered — NHS prescriptions and OTC sales — with the former having a pricing structure established by the Department of Health and the latter by the market.

In terms of gains from competition, the MPI has not yet recommended that NHS prescriptions should be subject to competitive pricing practices, since the Government currently sees this as a matter of public policy. Consequently, only the benefits in terms of consumer convenience, quality of services and lower OTC prices could be examined by the OFT.

Policy and competition

The MPI undertook the pharmacy investigation to see how present restrictions affect competition and consumer interests and whether there are better ways of achieving public interest objectives. Although the OFT exists to promote competition, its role is not always clear cut, particularly since control of entry regulations were introduced for a variety of public policy reasons much wider than consumer choice and were not designed to introduce distortions into the market for OTCs. Consequently, Ministers must now decide whether control of entry protects the public interest sufficiently to warrant the persistence of seemingly un-competitive markets for OTC drugs.

In response to this dilemma, the MPI remained mindful of the public policy objectives of the Department of Health, as well as the general need to make the OTC market more efficient.

What reaction the OFT recommendations receive within the Government, in part, depends upon the place in which they are considered. For instance, the Cabinet Office may respond in a different way to the Department of Health, since the former has to consider a whole range of conflicting interests while the latter is solely concerned with the provision of health services. However, the Department of Health could favour the OFT findings if it wishes to create an opportunity for giving primary care trusts (PCTs) new roles in controlling the location of local pharmacies in the future. Indeed, the new pharmacy contract planned for 2004 could be used to limit the number of pharmacies in each area, and PCTs could use this mechanism to control locations in place of the current national regulations.

The MPI's work

When analysing the OFT role in the pharmacy investigation, the following should be noted:

*** Formal guidelines on market selection had not been produced before pharmacy locations were chosen for investigation.**

*** The OFT produced its findings for Government — not legal — consumption.**

*** The Government is not tied solely by competition issues when deciding whether control of entry should remain.**

In response to the first of these issues, the OFT plans to produce guidelines for selecting future investigations for the MPI, but these have yet to be produced.

Given that the pharmacy study was one of the first for MPI, the experience may be used to decide which further markets are investigated. Based upon this experience, there is no reason why the expected guidance would permit studies such as pharmacy locations being investigated in the future, because they may be more an NHS policy issue than a competition concern.

As a result of the second of the above points, it could be the case that the information collected by MPI on the effects of contract limitation may have been handled differently because they were not being presented formally to a court. Indeed, the OFT has only produced recommendations for the Government, and these will be subject to a different type of scrutiny than the usual judicial output of the courts.

In other words, political considerations will affect the Government's response to the MPI's work.

Whether contract limitation remains will be a matter of argument and politics, and not an issue of the right evidence presented in the right way.

Finally, UK governments have rarely taken enhanced competition as a primary policy concern, and the case of pharmacy locations will test the degree to which The Enterprise Act 2002 has force.

We could now be entering an era in which public policy is determined by the private concern of the efficiency of markets —which was the logic that led to the privatisation of British Rail. As recent experience shows, services provided on efficiency grounds alone do not always lead to the best outcomes for consumers in terms of quality, safety or choice.

Balancing act

Acknowledging that the Government has concerns other than competition, the OFT stated that competition concerns should be balanced against the other public policy considerations. For instance, the OFT is aware that generally "there may of course be very sound reasons (including health, environmental and safety benefits for consumers) which outweigh any detrimental effect on competition in a market".

In the case of pharmacy, this view implies that the OFT clearly understands that the objectives of NHS policy must be carefully balanced against the Government's general policy of promoting greater

competition. However, the Government must decide how concerns about the provision of health services should be balanced against the ideological desire for lower prices or greater benefits for consumers without extra costs.

The effect on the market structure of pharmacies of reducing barriers to entry and increasing competition will be contingent on consumer demand because large supermarkets and the independent high street pharmacies compete on different bases. For instance, supermarkets may compete on price and having a large car park, while independents may compete on location and providing long-term, high trust relationships with customers.

Therefore, whether the removal of control of entry will significantly affect the long-term distribution of pharmacies will depend upon consumer preference for the "package" offered by the supermarkets or the independents.

Although the long-term effects are unclear, experience from other sectors suggests that greater competition produces retail agglomeration and small high street retailers tend to disappear. So, the effect of reducing barriers to entry can often have the perverse, medium term effect of reducing competition, since fewer, larger players dominate the market. In other words, the OFT could potentially be examining control of entry today and price collusion among large pharmacy chains in the future.

Consequently, the Government must be vigilant that the large supermarket retailers do not engage in predatory pricing to put small independents out of business, thus reducing the number of pharmacies and hence consumer choice.

One simple way of doing this is to maintain the existing control of entry regulations, which have known costs and procedures to ensure market stability and choice. However, within pharmacy, predictions about the future seem difficult to predict in the present climate. For instance, the most recent involvement by the OFT in community pharmacy resulted in the abolishment of resale price maintenance, which some claimed would also lead to a reduction in the viability of small independent pharmacies. This does not seem to have transpired, yet more resource was devoted by pharmacy interests in opposing the OFT over RPM than in the current enquiry, which is likely to have more far reaching consequences.

Similarly, particular consideration should also be given to the proposal for changing the structure and function of the NHS services provided by community pharmacy. For instance, are more or fewer independent pharmacies needed to provide medicines management schemes, prescribing and other health care roles? Some would claim that these are not best placed within supermarket or larger high street outlets and the ideal has yet to be identified.

A better approach might be to introduce these innovations of practice within the existing structure of control of entry and then identify whether such controls are to the detriment or benefits of such changes in services. In other words, what is needed is a more coherently planned approach to community pharmacy NHS service delivery than market force.

Conclusion

Clearly, the pharmacy locations case was a journey into unknown territory for the OFT. The MPI was a new department, with no formal guidelines to follow. Once formal guidance has been produced and the MPI gains more experience at cases that bridge both Government regulation and market competition, it may be the case that future investigations are handled in different ways. For instance, it is not clear whether the OFT should have reported that contract limitations costs the NHS approximately £10m in administration per year, since this is a "value for money", not a pricing, issue.

If investigations into consumer markets affected by Government policy lead the OFT into concerns about the operation costs of the NHS, then hospitals, general practice and many other health bodies should be investigated, since the degree of government subsidy to these services affects the ability of private providers to flourish.

Although there should be discussion about the role of OFT in determining public policy, the key issue of concern should be whether competition always and everywhere is a good thing?

If the Government believes needs, consumer protection, access and social justice come before competition in determining national policy for pharmacy locations, then the OFT has much more work to do before we should be convinced that the abolition of contract limitation is indisputably in the public's best interests.